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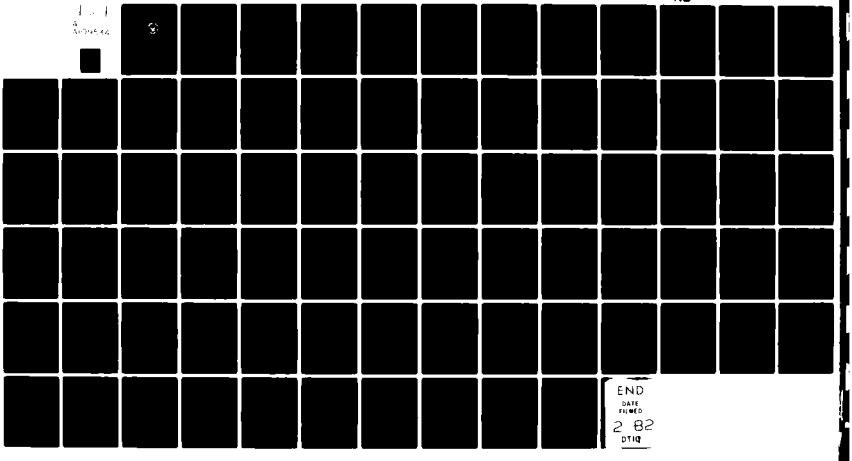

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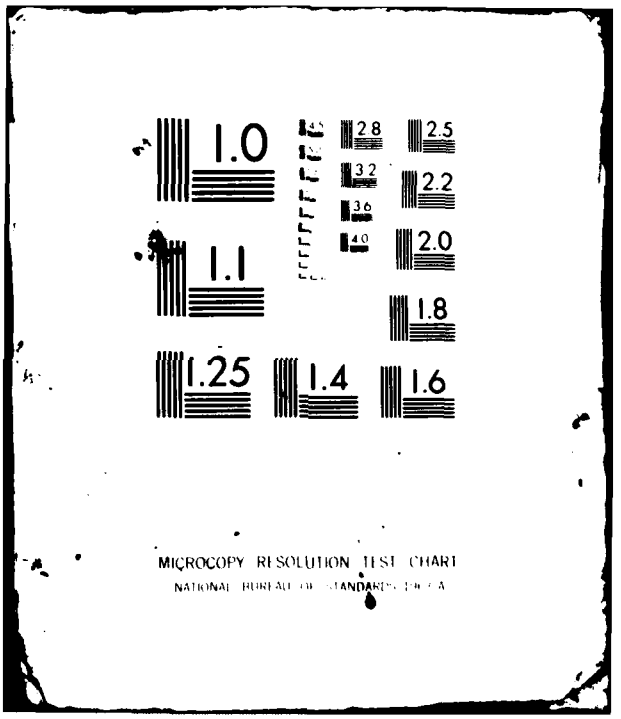
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THESIS

CONTRACTING WITH NATO INDUSTRY:
U.S. OR FOREIGN PROCUREMENT REGULATIONS?

by

William R. Bell

September 1981

Thesis Advisor: E. J. Laurance

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The U.S. Department of Defense policy on NATO standardization requires all major defense procurement be reviewed for standardization with NATO and whenever possible codevelopment/coproduction programs be initiated with NATO nations. Presently, U.S. procurement regulations dominate these joint efforts. However, existing international programs have experienced an increasing reluctance on the part of participating NATO nations to accept U.S. procurement regulations. Instead, these nations desire to apply their own procurement regulations to their domestic industries.

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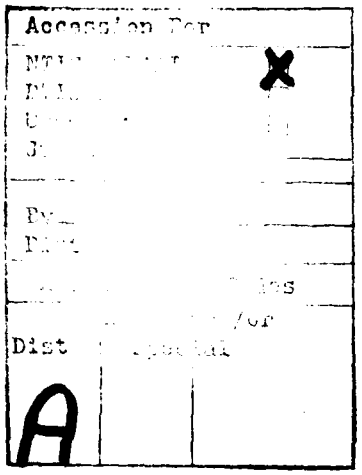

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Contracting with NATO Industry: U.S. or Foreign Procurement Regulations?

by

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Submitted in partial fulfillment of the
requirements for the degree of

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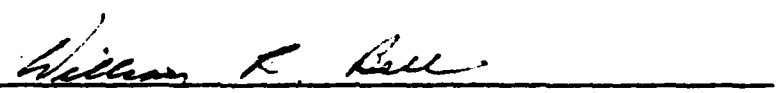
Author 

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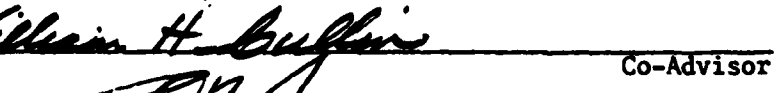
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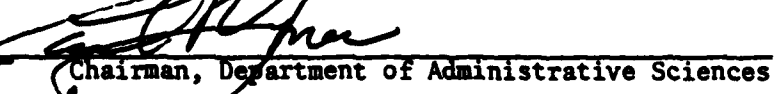
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ABSTRACT

The U.S. Department of Defense policy on NATO standardization requires all major defense procurement be reviewed for standardization with NATO and whenever possible codevelopment/coproduction programs be initiated with NATO nations. Presently, U.S. procurement regulations dominate these joint efforts. However, existing international programs have experienced an increasing reluctance on the part of participating NATO nations to accept U.S. procurement regulations. Instead, these nations desire to apply their own procurement regulations to their domestic industries.

This study identifies the problems experienced by the acquisition manager and U.S. industry on multinational programs resulting from the use of foreign procurement regulations and examines their implications for the Department of Defense's future acquisition policy. The study concludes that when the United States is the contracting nation, U.S. procurement regulations should be applicable to both domestic and foreign contractors.

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I. INTRODUCTION

A. GENERAL

The policy of rationalization, standardization, and interoperability (RSI) has acquired a greater importance due to the instability in the Persian Gulf, the Soviet invasion of Afghanistan, the present situation in Poland (1981), and the sustained arms build-up by the Warsaw Pact countries. To further this policy, the Department of Defense (DOD) and the Executive Branch are placing increased emphasis on transatlantic armaments collaboration and initiatives designed to better coordinate with other NATO allies the use of research and development resources and provide greater interoperability and standardization of weapon systems and equipment. As a result of these various programs, the acquisition manager is experiencing a greater involvement in the international contracting environment and facing many new challenges.

One of these challenges has been the melding into a business relationship the acquisition regulations for each country involved in a transatlantic cooperative program. Although difficult, it has been possible primarily as a result of U.S. procurement regulations dominating any U.S. sponsored transatlantic cooperative program. However, over the past several years NATO nations have, to various degrees, begun pressuring the U.S. to utilize the procurement regulations of the country where the contractor is located. Unless U.S. procurement officials fully understand the problems and implications of concessions in this direction, the U.S. may find itself in an untenable position in the years to

come. Once changes in the U.S. procurement system are made to accommodate foreign procurement regulations, they cannot be easily reversed.

B. OBJECTIVES

The objectives of this study were to identify the problems encountered in the use of foreign procurement regulations in the international contracting process and to examine the implications for future Department of Defense acquisition policy.

C. RESEARCH QUESTIONS

Given the above stated objectives, the following research question was posed in this study:

What are the problems and implications for the Department of Defense in contracting with the industries of NATO nations for U.S. defense material in accordance with foreign procurement regulations as opposed to U.S. procurement regulations?

The following subsidiary questions were developed in order to address this research question:

1. How has DOD become involved in the use of foreign procurement regulations in international contracting?
2. What is current DOD policy on the use of foreign procurement regulations in international contracting?
3. What U.S./foreign procurement regulation differences present the greatest problems in the use of foreign procurement regulations in international contracting?
4. What has been the experience of DOD acquisition personnel in the use of foreign procurement regulations in international contracting?

5. How would an agreement by DOD to contract under the foreign procurement regulations of one NATO nation affect procurement agreements with other NATO nations?

D. SCOPE

The scope of this research is limited to a case study of the use of foreign procurement regulations in the codevelopment/coproduction of the Rolling Airframe Missile (RAM) system involving the United States, Federal Republic of Germany, and Denmark. The research is intended to identify the principal problems from the use of foreign procurement regulations which impact on the acquisition manager and U.S. industry and from these problems examine the implications for the Department of Defense's future acquisition policy.

E. ASSUMPTIONS

Throughout this study, it is assumed the reader is familiar with standard Department of Defense contracting terminology, procedures and concepts, with the DOD program management structure and operations, and possesses a general knowledge of NATO rationalization, standardization, and interoperability policy.

F. METHODOLOGY

The research methodology used in this study consisted primarily of a comprehensive review of the literature base and the use of personal and telephone interviews with government and industry acquisition personnel involved in the international contracting process. The literature base was collected through the Naval Postgraduate School library, the Defense

Logistics Studies Information Exchange (DLSIE), and the Defense Systems Management College (DSMC). Telephone and personal interviews were held with program managers, business/financial managers, contracts personnel, other government officials attached to the Office of the Deputy Secretary of Defense (Acquisition Policy), Chief of Naval Material, Naval Sea Systems Command, Naval Plant Representative Office, General Dynamics, Rolling Airframe Missile Program Office, Explosion Resistant Multi-Influence Sweep System Program Office, and with contractor personnel at General Dynamics Corporation.

Additional data presented in this study was obtained from an examination of regulations, directives, instructions, guidelines, acquisition plans, contracts, and other applicable program office and contracting office files and records.

G. ORGANIZATION

This thesis consists of six chapters. Chapter II gives a historical perspective to provide a background of the current international acquisition arena. Chapter III provides an overview of the acquisition manager's international contracting environment and major considerations. Chapter IV identifies the problems currently experienced with the use of foreign procurement regulations in international contracting and examines their implications for DOD. Chapter V illustrates how some of these problems have been dealt with on a specific program. Finally, Chapter VI integrates the problems and their implications with conclusions and recommendations.

II. BACKGROUND

A. DOD RATIONALIZATION, STANDARDIZATION, AND INTEROPERABILITY (RSI) POLICY DEVELOPMENT

After World War II, the United States furnished more than $21 billion in military assistance to the European NATO nations during a period of thirty years. This military assistance not only allowed these nations to begin rebuilding their industrial base but ensured a partial standardization of NATO armaments through proliferation of U.S. weapons and equipment. As these European nations made progress with their task of rebuilding and became less dependent on the United States for direct military assistance, this partial standardization of NATO armaments continued through the market created by the European dependency on U.S. weapons and equipment [1:269].

As the economic prosperity of the European allies increased, U.S. foreign policy shifted in the 1960's away from military assistance to trade. The European nations were expected to become more self-reliant by redeveloping their own defense industries. To accomplish this, it was essential they enter into bilateral and multilateral arrangements given their small national markets and the high cost of developing and fielding new technology. This led the European nations to develop the transnational corporation, redevelop their technology base, and search out third world markets. The European industrial base became strong enough by the 1970's to permit joint development and production of weapons systems which were exclusively European [2:1-4].

While commendable, this rematuration of the European industrial base created political, economic, and military problems for the United States.

Militarily, the recovery and technological advancement of the European industrial base led to the replacement of U.S.-built weapons and equipment with European-built equipment, thus contributing to a destandardization of NATO armaments. Logistical, doctrinal, and other related problems which normally would have lain dormant surfaced, creating a threat to the survivability of U.S. troops in Europe [2:1-4].

Economically, the advancement and recovery of the European industrial base has presented a challenge to the United States in third world markets which previously were the sole domain of the U.S. Europe has always been an export oriented economy due to lack of the necessary domestic demand required to realize economies of scale. Therefore, it was only natural Europe should look to third world markets to restore itself to the economic position occupied before World War II. In the 1970's this brought about a decline in the monopolistic control of the U.S. arms industry over the military hardware market. Thus the economic stability of the United States was being challenged. Further evidence of this fact was the devaluation of the dollar, the growth and size of European multinationals and emphasis on the astute use of resources in Europe [2:1-4].

Politically, the European recovery presented the United States with a European industrial base organized along national and transnational lines and now fully capable of refusing to fall in line with U.S. policy. Thus, the NATO alliance was no longer soft and pliable to the pressures of its North American allies. In total, the United States was being challenged militarily, economically, and politically by its own allies. [2:1-4].

The military challenge was recognized by the United States in the 1950's and 60's, but not until the 1970's did the full economic and political impact become clear. By the 1970's the European allies were no longer asking for a share of the military hardware market but demanding it. If they were not given this share, European markets would be shut off to the United States and Europe would develop its own defense industrial base and technology in such a way as to be destructively competitive with the U.S. This European initiative was made clear in testimony before the Special Subcommittee on NATO Standardization, Interoperability, and Readiness by the Advisor to the Secretary of Defense on NATO Affairs, Ambassador Komer. He stated: [3:17]

> I think we are kidding ourselves if we think Europe will keep buying as much from us if we don't buy more from them. The handwriting is on the wall as far as this problem is concerned.
>
> The British, the Germans, the Belgians, the Norwegians, the Canadians, and the Dutch have put us very clearly on notice...either we're going to give the allies a somewhat bigger share of our market or they're increasingly going to go for their own equipment, even if ours is better and cheaper. It's as simple as that because we do the same thing.

Therefore, it was the economic and political challenge as much if not more than the military challenge which spurred the United States to take action.

The United States needed to develop a policy which would not require the European allies to sacrifice their new industrial or technological capability, yet would halt the trend toward armament destandardization, recognize the full partnership of the European allies, and protect the U.S. defense industrial base. Since the European allies are heavily dependent on the U.S. nuclear umbrella and willingness to protect Europe, and any effort that contributed to the military effectiveness of the

alliance would receive support of all members, that policy became rationalization, standardization, and interoperability (RSI). That the policy would receive full support was especially true in light of the concern over the large build-up of conventional forces by the Warsaw Pact nations. To preserve the industrial and technological capability of the European allies and protect the U.S. defense industrial base, the policy calls for a closer U.S./European cooperative effort in the design, development, and production of weapon systems, hence, a "two-way" street of technology and technical know-how. This concept is essential to the policy as an incentive for European cooperation. The "two-way" street is actually: [2:5]

> an attempt to establish a long-term military, economic and political relationship with Europe that does not encourage them to slowly but summarily shut off their markets to us.

Therefore, NATO RSI can actually be viewed as a national policy, military in thrust but equally as important economically and politically [2:5-6].

Congress expressed its views on NATO RSI policy through Public Law 94-361, Sections 802 and 803, of 14 July 1976, which is commonly referred to as the Culver-Nunn Amendment to the Department of Defense Appropriation Authorization Act of 1977. This legislation is the charter for NATO RSI policy and regarded as the most authoritative statement of policy on standardization and interoperability of any NATO ally. The amendment states: [3:10]

> It is the policy of the United States that equipment procured for the use of personnel of the armed forces of the United States in Europe...should be standardized or at least interoperable with equipment of other members of the North Atlantic Treaty Organization.

To implement this policy the Amendment requires that: [3:10]

> The Secretary of Defense shall to the maximum feasible extent initiate and carry out procurement procedures that provide for the acquisition of equipment which is standardized and interoperable.

The Culver-Nunn Amendment also authorized the waiver of the "Buy-American" Act by the Secretary of Defense when required to procure standardized or interoperable equipment in the best interest of the national defense.

President Carter placed executive branch emphasis on NATO RSI policy when he stated: [4:6]

> As we strengthen our forces, we should also improve cooperation in development, production and procurement of Alliance defense equipment. The Alliance should not be weakened militarily by waste and overlapping. Nor should it be weakened politically by disputes over where to buy defense equipment...we must make a major effort...to eliminate waste and duplication between national programs; to provide each of our countries an opportunity to develop, produce and sell competitive defense equipment; and to maintain technological excellence in allied combat forces.

DOD promulgated Directive 2010.6 on RSI policy in March 1977 based on the above congressional legislation and executive branch guidance. The current revision of the directive issued in March 1980 has essentially the same policy guidance as that issued in 1977. The directive states, in part, that: [5:1-2]

> It is the policy of the United States that equipment procured for U.S. forces employed in Europe under the terms of the North Atlantic Treaty should be standardized or at least interoperable with equipment of other members of NATO.
>
> Accordingly, the Department of Defense shall initiate and carry out methods of cooperation with its allies in defense equipment acquisition to improve NATO's military effectiveness and to provide equitable economic and industrial opportunities for all participants.
>
> The Department of Defense will also seek greater compatability of doctrine and tactics to provide a better basis for arriving at common NATO requirements.

The goal is to achieve standardization of entire systems, where feasible, and to gain the maximum degree of interoperability throughout Alliance military forces.

The directive also clarifies the terms of "rationalization," "standardization" and "interoperability." It offers the following definitions: [5:1-4]

Rationalization. Any action that increases the effectiveness of allied forces through more efficient or effective use of defense resources committed to the Alliance. Rationalization includes consolidation, reassignment of national priorities to higher Alliance needs, standardization, specialization, mutual support, improved interoperability, or greater cooperation. Rationalization applies to both weapons/material resources and non-weapon military matters.

Standardization. The process by which member nations of NATO achieve the closest practicable cooperation among forces, the most efficient use of research, development and production resources, and agree to adopt on the broadest possible basis the use of: (a) Common or compatible operational, administrative, and logistic procedures; (b) Common or compatible technical procedures and criteria; (c) Common, compatible, or interchangeable supplies, components, weapons, or equipment; and (d) Common or compatible tactical doctrine with corresponding organizational compatability.

Interoperability. The ability of systems, units, or forces to provide services to and accept services from other systems, units, or forces and to use the services so exchanged to enable them to operate effectively together.

DOD has also included RSI policy guidance in its directives on major weapons system acquisition. The current revision of 19 March 1980 to DOD Directives 5000.1 and 5000.2 provides: [6:4]

NATO rationalization, standardization, and interoperability (RSI) shall be basic considerations in acquisition of systems having a partial or total application to Europe.

DOD components shall take action in the following areas: [7:18-19]

Consider NATO country participation throughout the acquisition process. This includes standardization and interoperability with other NATO weapon systems.

> Consider NATO doctrine and NATO member threat assessments. In development of MENS, mission needs of NATO members shall be considered.
>
> Solicit NATO member contractors for bids and proposals on U.S. systems and components when such an opportunity is not precluded by statute or by the national disclosure policy.

In addition, DOD Directive 5000.2 lists factors to be considered during evaluation of alternative system concepts.

DOD has continued to emphasize and support NATO RSI. The greatest concern now, as in the 1970's, is that the U.S. can no longer match the output of the Warsaw Pact military-industrial base by its resources alone. In testimony before the Congress in early 1980, the Commander-in-Chief, U.S. European Command, General Bernard W. Rogers, said that the risks and opportunities faced in the 1980's: [8:12]

> ...must be assessed against the backdrop of a relentless accumulation of Soviet military power over the past 15 years. This military power has accrued, not as a result of some sudden shift in priorities, but rather from a momentum derived from conscious allocation of some 13-15 percent of the Soviet GNP to their defense budget, with a 4-5 percent real increase each year.
>
> Of special concern is the effect of these sustained investments on the military-industrial complex of the Soviet Union, which now contains the largest research and development manpower base in the world; receives almost twice the investment funds of any Alliance nation; and outproduces NATO at the rate of two or three to one--or more--in most major weapons systems. It is an industrial base capable of producing vast quantities of high quality operational equipment in a relatively short time.

DOD has recognized that comfort can no longer be found in the belief that somehow allied quality can overcome Warsaw Pact quantity. Recently, greater emphasis has been placed on the issue of burden sharing by the allies. This is especially true in view of the fact that many of the NATO nations failed to attain the agreed goals of a three percent increase in defense expenditures to build up NATO's defenses [8:13].

However, this U.S. issue of burden sharing is counter balanced by the European issue of benefit sharing. The Europeans have long desired the economic benefits (jobs and technological pride and progress) from the developing, producing, and selling of weapons to the U.S. The factor which prevents this from taking place is Europe's fragmented industrial base. Only three countries (Britain, France, and Germany) can produce weapons on a continental scale, and no European country can produce weapons on an intercontinental scale. This has prohibited the NATO allies from producing weapons competitive in quality, quantity and price with those in the U.S., making a transfer of benefits impossible. As DOD enters the 1980's, the initiative in this area is for DOD to continue to be the catalyst in promoting the resolution of the burden/benefit sharing issue [8:13-14].

DOD has confirmed its policy of continued support and the support of the Reagan Administration for RSI and armaments cooperation with our NATO allies in a June 1981 memorandum from the new Deputy Secretary of Defense, Frank C. Carlucci, which states in part: [9:1]

> ...more effective cooperation in armaments is now an imperative. The Reagan Administration strongly supports U.S. and NATO cooperative programs and initiatives that are designed to better coordinate our use of research and development resources and provide greater interoperability and standardization of our forces...we will strive for cost effective cooperative programs, whenever possible, which can meet U.S. and NATO Alliance requirements.

Therefore, international cooperative programs with NATO RSI will be the primary thrust of DID current efforts into the 1980's.

B. DOD CURRENT RSI INITIATIVES

DOD military initiatives for RSI have taken on increased emphasis due to the instability in the Persian Gulf, the Soviet invasion of Afghanistan, the present situation in Poland (1981), and the sustained arms build-up by the Warsaw Pact countries. The principal objective in Europe is to deter a Soviet invasion but should that invasion come the NATO Alliance must be able to defeat it. This means coalition warfare, a kind of warfare dependent on standardization and interoperability of weapons and equipment for effectiveness. To meet this challenge, the Office of the Secretary of Defense has continued in the 1980's to build on a series of initiatives to carry out the U.S. policy on RSI and armaments cooperation with our NATO allies. These initiatives are: (1) mutual defense cooperation through reciprocal procurement agreements; (2) dual production of weapon systems which have already been developed; and (3) sharing the development of next-generation families of weapons [8:81].

Mutual defense cooperation applies to memoranda of understanding which are reciprocal agreements between two or more countries intended to promote arms cooperation and the review of armament programs and trade to determine efficient uses of NATO resources through increased competition. MOU's have been a primary means of furthering RSI within NATO through cooperative action [5:2].

MOU's may be general or specific depending on their purpose. General defense MOU's have various objectives, such as the waiver of "buy-national" restrictions, increased cooperation in research, development, procurement and production for greater standardization and interoperability,

and to provide clarification of procedures stated in supplemental specific MOU's. To date, general MOU's have been negotiated with twelve NATO countries: the United Kingdom, Canada, France, Germany, Norway, the Netherlands, Italy, Portugal, Belgium, and Denmark. A current accomplishment by DOD is the negotiation of two additional MOU's with Turkey and Greece. This accomplishment now places agreements on armament cooperation with all NATO nations which have significant defense industries [8:82] [11:3-3].

While general MOU's establish basic guidelines regarding cooperative efforts between nations, more "specific" MOU's are required to cover individual programs. Each "specific" MOU sets the level of reciprocity, but separate technical agreements cover the detailed procedures in such areas as financial arrangements, cost sharing formulae, or additional coproduction. Examples of weapon specific MOU's are: [5:18]

> Cooperative Research and Development. Any method by which governments cooperate to make better use of their collective research and development resources to include technical information exchange, harmonizing of requirements, codevelopment, interdependent research and development, and agreement on standards.
>
> Coproduction. Any method which (1) enables an eligible foreign government, international organization, or designated commercial producer to acquire the technical information and know-how to manufacture or assemble in whole or in part an item of U.S. defense equipment for use in the defense inventory of the foreign government; or (2) acquires from a foreign government, international organization, or foreign commercial firm, the technical information to manufacture domestically a foreign weapon system or subsystem for use by the Department of Defense.

DOD has recently negotiated a number of new weapon specific MOU's between individual nations for cooperation in the development and production of specific systems. Two of these agreements are the cooperative development of the Rolling Airframe Missile (RAM) with Germany and Denmark

and the cooperative development of the Multiple Launch Rocket System (MLRS) with Germany, France, and the United Kingdom [10:4-5].

In order to place these MOU's with other nations into action, DOD is presently holding industrial seminars with government and industry representatives from these nations. These seminars, which have led to greater arms cooperation, are designed to explain the acquisition policies and procedures of each nation and to provide an opportunity for the exploration of possible U.S. and European "teaming" efforts. A key concept being stressed by DOD at each of these seminars is the reciprocity of MOU's. This means that bids for requirements from all participating nations must be treated on an equal basis [8:82].

Dual production is the second DOD initiative toward achieving increased RSI through armaments cooperation. Under this approach, a system valuable to the Alliance which has already been developed by a member nation would be produced by other nations in the Alliance. This approach would lead to the near-term introduction to NATO forces of weapon systems with the latest technology and to avoiding the developmental costs of redundant programs [5:2].

Congress has conflicting views as to whether dual production actually does reduce costs and decrease weapon system production time. The Committee on Appropriations, House of Representatives, in a 1979 report stated: [1:271]

> This type of collaboration does little to procure for the NATO Alliance the strongest possible defense force for the total funds available. On the contrary, this type of production collaboration actually costs the NATO countries substantially more than if they had purchased the systems directly from producing nations. These additional costs, primarily incurred in establishing duplicate production facilities, tooling, test equipment, and training

> employees for the production work along with the additional time lost in setting up the production capabilities, seems to be inherent in all cases of this type of collaboration.

However, the Committee went on to say that in large dual productions costs to each country were reduced. It stated: [1:271-272]

> ...in cases where few duplicative production lines serve a large number of procuring countries, the share of the R&D costs to be assumed by each country is substantially reduced and the number of items produced by each production line is substantially increased. As a result, the cost per unit for each country is also reduced....Coproduction increases the total costs to about 150 percent of the total costs of procuring the total number of units from a single production line. Under the coproduction arrangement, however, the cost of each country becomes about 75 percent of independent production in its own country.

Nevertheless, DOD is still pursuing the dual production approach, notwithstanding such criticism. Many new systems are now or will soon be produced under license in Europe and the U.S. Examples of such systems produced in the U.S. are the Italian Oto Melara Mk75 Gunmount, the French/German Roland Short Range Air Defense System, the Belgian MAG-58 Machine Gun for Armored Vehicles, and the German 120mm Smooth Bore Tank Gun. U.S. systems which are being produced in Europe are the F-16 Fighter, AIM-9L Air-to-Air Missile, and the M113 Armored Personnel Carrier [8:82].

The third DOD initiative toward achieving increased RSI through armaments cooperation is the families of weapons approach. Under this approach, participating NATO nations attempt to reach early agreement on the assignment of responsibility for developing complementary weapons systems within a mission area. Weapons to be developed by each nation in the near future are examined and grouped by mission area. The development of the weapon systems is coordinated whenever possible. Again, the objective of this approach is to save R&D funds through reducing duplication of weapon system development efforts [5:2].

The family of weapons approach is the most recent of the three DOD initiatives to become a reality. Because the concept is so new, there has not been time to determine if two possible problems which could inhibit its effectiveness will be encountered.

The first possible problem is a security issue which involves the U.S. longstanding policy of maintaining the capability to produce all the components of its weapon systems within the country. Many government officials believe the technological gap left by not maintaining this policy would be detrimental to national security [1:271].

The second issue which may become a problem deals with the national pride of the European nations and their desire to keep their work forces employed. This may prompt European countries to choose weapon systems produced in their country even if the systems are not the best available. A survey conducted in the U.S. and Europe disclosed that of greater priority to the European nations than savings to the Alliance through reduction of R&D efforts was employing their work forces without any drastic reductions in size. Whether or not these two issues become problems remains to be seen [1:271].

The first MOU making the family of weapons concept a reality was signed by the U.S., the U.K., and Germany for air-to-air missiles in August 1980. Under this MOU, the U.S. will develop an Advanced Medium Range Missile (AMRAAM) while Germany and the U.K. will develop an Advanced Short Range Missile (ASRAAM). Expected results of this program, which may be optimistic, are savings of from $400-500 million in R&D costs as well as an improved air combat capability for the Alliance.

Other family of weapons MOU's have been signed or are being negotiated and are near the signature stage [8:83].

Other current RSI initiatives by DOD which should be mentioned are: the continued program for implementation of RSI within DOD; the training of DOD acquisition personnel and U.S. industry for the growing international business environment; investigation of second sourcing in Europe; and the review of foreign ownership, control or influence regulations (FOCI).

DOD is continuing its active role of implanting the principles of RSI in its internal procedures. The March 1980 revision of DOD Directive 2010.6, "Standardization and Interoperability of Weapon Systems and Equipment within the North Atlantic Treaty Organization," brings together all major DOD policies, procedures, and component responsibilities for achieving RSI objectives. Immediately following its revision is the revision of DOD Directive 5000.1 and DOD Instruction 5000.2 which set forth detailed policy and procedures on major systems acquisition. Practices that individual services must follow to insure RSI concerns are taken into consideration in the acquisition of major systems are detailed in these documents [8:89].

Increased emphasis by NATO on DOD's triad of initiatives for armament cooperation has forecast the opening of defense markets and increased international acquisition in NATO for the 1980's. To prepare DOD acquisition personnel and U.S. industry for doing business in the international environment, DOD has embarked on and completed or is in the process of completing a number of initiatives which are: [8:90]

(1) Revise Section VI of the DAR, Foreign Purchasing

(2) Conduct a multinational codevelopment/coproduction workshop to assimilate DOD experience to date

(3) Expand the Defense Systems Management College Basic Course on International Program Management

(4) Develop international acquisition "guides" and conduct "International Acquisition Strategy" panels for program managers

(5) Explore ways to conserve NATO government managerial resources in the international business environment

DOD is also exploring the possibility of procuring major defense systems from Europe as a second source. U.S. purchases from European production runs could be economically beneficial as well as logistically advantageous in terms of providing equipment more rapidly to using units [8:89].

Finally, DOD is reviewing Foreign Ownership, Control or Influence regulations to ensure policies adequately protect classified technological information while not inhibiting progress toward NATO RSI [8:90].

C. IMPACT OF INTERNATIONAL CONTRACTING ON THE ACQUISITION MANAGER

As previously stated, RSI policy has acquired increased emphasis as a result of the instability in the Persian Gulf, the Soviet invasion of Afghanistan, the present situation in Poland, and the sustained arms build-up by Warsaw Pact countries. The primary vehicle DOD intends to use to further this policy is international cooperative programs with our NATO allies. The acquisition manager is assured of experiencing greater involvement in the international arena as he is tasked with effecting business relationships between the parties of transatlantic cooperative efforts. The challenges he will face from the contracting aspect alone are numerous.

The acquisition manager will have to acquire knowledge of the general characteristics of the European industrial environment. He will

require a more detailed working knowledge of the specific characteristics surrounding the defense industry in the country or countries with which he is doing business. Many of these environmental factors which have created substantial differences between the U.S. and European procurement systems will become major hurdles to overcome in effecting business relationships with the European countries.

The different views on competition by the U.S. and Europe will generate problems for the acquisition manager in selecting foreign contractors for a program and complying with the U.S. requirement that competition is the preferred method to be used.

The different views and means by which U.S. and European societies carry out socio-economic objectives is another problem in that these different methods can drive the cost of a program upward.

The acquisition manager will encounter many problems in the financial aspects of international contracting. He will have to devise methods to establish the price of a contract which will not be affected later by fluctuations in the value of currencies.

Another financial problem to overcome is the difference in pricing regulations. The accounting systems of the European countries differ to varying degrees from the U.S. system. Many costs which are unallowable by law in the U.S. are allowable under foreign accounting systems. Also, these costs may not be separated from other costs as required in the U.S. The acquisition manager is faced with the problem of establishing a financial system which complies with U.S. laws and regulations yet does not attempt the impossible--changing a foreign nation's traditional system.

A third financial problem the acquisition manager must solve, is how to audit the books and records of a foreign contractor in accordance with the U.S. requirement and to do so without becoming an unacceptable intrusion into the foreign country's affairs.

A problem of another type over which the acquisition manager may not have any control, but in which he shares considerable interest with the European nations, is technology transfer. This decision may not be singularly left to him but may require approval from many different agencies of the U.S. Government. However, once approved, the acquisition manager has the responsibility to ensure that the transfer of technology is properly accomplished and procedurally controlled. What he will find in the international arena is that the procedures many foreign governments have concerning licensing, patents and data rights differ significantly from the established procedures in the United States [12:2].

For example, in the Federal Republic of Germany, all intellectual property rights are retained by the contractor, who commits himself to licensing all required intellectual property to a second source designated by the FRG Government. In the U.S. the government retains the rights to the intellectual property for which it has paid to have developed. However, the government cannot transfer the data to a foreign nation without contractor consideration. This is but one example of many such differences between U.S. and European systems. It should be pointed out that the European system itself is not uniform, but procedures vary from country to country.

A final difference in the U.S./European environment which will be mentioned that impacts on all aspects of the acquisition manager's task

is the language barrier. In the process of melding the requirements of each country's acquisition regulations, the acquisition manager will find that the legal meaning of many contract clauses in English is interpreted totally differently in another language. Translation of these clauses may be difficult or impossible. Also, the language barrier problem is one to be reckoned with at the negotiating table.

The continual expansion of the acquisition process into the international arena will present numerous problems such as these and others for the acquisition manager. As doing business internationally becomes more and more a necessary fact of life, he must make the transition from a domestic to an international acquisition manager.

III. INTERNATIONAL CONTRACTING

A. GENERAL

As indicated in the previous chapter, armaments cooperation between the U.S. and European allies will be increasing in the 1980's. The acquisition manager will be experiencing greater involvement and challenges in the international business environment and must make the transition from domestic to international acquisition manager. To accomplish this, he must learn his new environment and master the unique requirements of contracting in the international arena. The purpose of this chapter is to provide an overview of the European contracting environment and to identify some of the acquisition manager's major considerations in formulating acquisition strategy and in contract management.

B. EUROPEAN CONTRACTING ENVIRONMENT

Key to an understanding of the European contracting environment is an understanding of the general characteristics of the European defense industry. One of the most important characteristics is its division among three "tiers" of countries.

The first tier comprises Germany, France, and the United Kingdom, which are the three most industrialized countries in Western Europe. These countries account for approximately 80 percent of Western Europe's arms industry output, although these countries only represent about 54 percent of the NATO European population.

The second tier is comprised of the next three most industrialized and populous countries, which are Italy, the Netherlands and Belgium.

These countries are responsible for approximately 12 percent of arms industry output while accounting for only 25 percent of the NATO European population.

The third tier is comprised of the remaining NATO countries which account for 8 percent of the arms industry output while only 22 percent of the NATO European population [11:12-1].

Of the first tier countries, France and the United Kingdom export more arms than they import, indicating that their arms market is larger than just domestic consumption. Germany has also become a net exporter of arms during the past three years it has been a member of NATO. Of the second tier countries, Belgium and the Netherlands have in recent years balanced their own domestic demand with their production capacity. However, Italy has moved up into the consistent net exporter ranks [11:12-1].

The greatest amount of attention has been focused on the first tier countries because as stated they alone account for approximately 80 percent of the NATO defense industry. An important characteristic in addition to size and role which applies primarily to France and the United Kingdom but also to Germany is that a wide spectrum of technologies and weapon systems are covered by their armament industries. None of the second or third tier countries are characterized by a wide spectrum of weapon systems, while they may meet the criteria for technologies. The second tier countries do have individual companies that have been suppliers of specialized weapons to other NATO and non-NATO countries for a long time [11:12-1].

The defense industries of France and the United Kingdom develop and produce the widest number and types of armaments and associated

technologies, with France being the largest. They cover the complete spectrum from independent nuclear weapons and strategic missile development and production to the production of small arms and ammunition. This national policy seems to evolve from a desire for independence or equality with other NATO partners. On the other hand, Germany has resolved not to develop and produce nuclear weapons or strategic missiles. Only recently has the German aerospace industry received government support and been allowed to expand [11:12-1].

Codevelopment is considered by the first tier countries to be an essential segment of multinational collaboration, including cooperative arrangements with the U.S. This has been insisted on for a long time by industries in France and the United Kingdom, but not until recently have German industries insisted that codevelopment be part of any transatlantic collaboration in lieu of U.S. licenses without codevelopment. Also being advocated is that any transatlantic collaboration should be carried out between a European multinational group and the U.S. rather than on a bilateral basis [11:12-2].

Of equal importance to understanding the general characteristics of the European defense industry is an understanding of the European government/industry relationship. There are a number of organizational and legal forms which represent this relationship.

In the U.S., the defense industry is characterized primarily by independent industrial corporations which are publicly owned through stock which is traded. In Europe, many key industries, such as in France and the U.K., are nationalized and totally or almost totally government owned. For the rest of the individual companies throughout Western

Europe, the tradition of private ownership holds true. However, as in the U.S., many individual companies are totally or almost totally owned by conglomerates which in many cases may be foreign owned multinationals. As a general rule throughout Western Europe these individual companies are operated by professional corporate managers who are normally employees rather than owners of the companies [11:12-10].

The relationship of European governments to industry is also based on the function of markets and broad government policy. European defense markets are only one-eighth to one-tenth the size of U.S. markets and therefore cannot support more than one to three companies in the defense industry. Exports do not relieve this problem since the purchasers of exports are hesitant to buy weapons not used in the exporting nation's own armed forces. The small market size thus confers an almost "sole-source" status on the small number of European defense industries [11:12-11].

However, it should be mentioned that the sole-source nature of European defense industries does not decrease their dependence on export markets for their financial and economic health. Exports are still a primary concern of government and industry from the arms balance of trade viewpoint and the augmentation of production to reduce R&D costs [11:12-11].

Another key concept which is important to recognize, for a clear perspective on the European contracting environment, is that there is considerably less competition in Europe. This difference between the amount of competition in U.S. and European defense acquisition is a major hurdle to overcome in transatlantic collaboration. The reason for less competition in Europe is both historical and structural, with the historical

aspect being of less importance. Briefly, the historical aspect of European competition is related to the ancient guild system with its restrictions on the entry into and control over practices of the various trades and professions. As large industries have developed, this guild system has been replaced by large industrial unions which now have become the important centers of labor and trade influence [11:4-8].

The structural aspects are much more influential in creating less competition in Europe than the U.S. Essentially there are two significant factors which are closely connected. The first factor is concerned with the size of the market. Although the first and second tier NATO nations have as many varied defense systems as the U.S., the production numbers of such systems in these nations are much smaller. Also, the third tier nations do not have as many varied defense systems as a result of their limited access to export markets, and this makes production of many types of systems impractical and economically infeasible for them. These economic limitations on the large and small nations which reduce the market size create the second factor, which is a fewer number of companies to generate competition. Further reducing the number of companies, is the heavy emphasis placed on mergers by the European governments. While these mergers tend to strengthen the European industrial base, they have reduced the number of companies in some areas of the European defense industry to as few as two.

The limited amount of competition in the European defense industry also creates a difference in U.S. and European business policies, which is another characteristic that should be recognized. European business practices are aimed at the cooperation and integration of the limited

market and technological-industrial base resources which are available. For weapon system collaborative efforts in Europe, the key issues become the number of each nation's employees that will participate in the work, the amount of technology that will be shared in research and development and the size of the market each nation receives. Collaborative efforts such as these are usually only conducted for those projects in which a common requirement has been identified and the sources to carry out the project from design to production selected [11:4-8,9].

Another aspect of European business policies which is different from the U.S. is that weapon systems acquisition programs are not reviewed each year by the government and subject to the possibility of cancellation. Once a commitment is made for a program, it is made for the planned life of the program. European programs are therefore often more stable and assured funding for the entire program [11:4-9].

Still another characteristic of the European contracting environment is the educational level of industry personnel. In Europe, the backbone of industry is made up of the non-university engineers and the center of the workshops consists of the trademasters. A non-university engineer completes his education in about seven years. He spends 25 hours in the classroom and 15 hours on the drafting board and in the workshop per week. A trademaster also completes his education in about seven years but with 10 hours in the classroom and 30 hours on the shop floor per week. On the other hand, a university engineer completes his education in about five years, with approximately 35 hours in the classroom and seven hours on the shop floor per week. This varied education permits greater flexibility in industry by enabling these industry personnel to

communicate down to the shop level and up to the development laboratory. This wide talent distribution permits flexible manufacturing programs which allow European industry to achieve efficient production of small lots. The U.S. instead utilizes large manufacturing programs with high specialization and large outputs [11:4-5].

Another difference characteristic of the European environment is in the area of taxation. There is no codified general "European tax theory." However, there is a common view which is shared by Europeans toward taxation and more specifically toward the definition of profit. The European approach to taxation is a practical one. This approach has evolved out of the lessons learned by the Europeans from World War II which ended with the complete collapse of the European economy. The essential element of the approach taken by European governments is the view that private business is a source of employment and government should support business in a number of ways, such as tax incentives, minimum legislative constraints, and protection. Private business is to help pay for a large portion of social benefits, like social security, in return. Therefore, this approach ties together the elements of profit, social benefits, and job security [11:4-9,10].

In line with this approach, European governments attempt to foster segments of private business through the application of short-term depreciation. This generates new business in a specific segment as a result of the large tax incentive created. Also, in Europe, private business cannot only recoup the original capital invested in plant and equipment, which is the usual purpose of depreciation, but accumulate capital toward the replacement value as well. This is not permitted in the U.S. [11:4-10].

Another tax incentive utilized by European governments to foster private business is the tax-free profit incentive. To spur industrial growth when desired, many governments declare tax-free, profits re-invested in the company of origin within one year. This discourages the migrating of profits through diversification [11:4-10].

A final characteristic, which should be discussed, is the European labor stability and compensation practices. In Europe, there is no formal legal obligation which requires industry to stabilize its labor force. However, it is a reality which is enforced by institutionalized actions, such as union contracts which address severance pay, complaint procedures, etc. The closest example to this situation in the U.S. would be efforts by Congress to pass job protection laws in the case of factory closings or relocation. These widespread restraints on the layoff of personnel tend to drive European production costs upward. It is this European goal of maintaining the employment level at the expense of increased industrial capability or employment which makes cost effective cooperative efforts difficult [11:4-11].

There are several compensation factors which should be noted. Total compensation for the European worker tends toward a larger percentage of fringe benefits, than for a U.S. worker. This tends to provide a greater motivation for European workers to remain with the same company in order to retain their benefits, thus creating very low mobility. Vacation needs of European workers are met through entire plant shut-downs which create a certain amount of inflexibility. Finally, there are strict regulations on overtime and shifts which further contribute to this inflexibility.

These factors create scheduling obstacles to integrating cooperative programs which are difficult to overcome [11:4-11].

These characteristics of the European contracting environment are only a small portion of those which could be discussed. The acquisition manager must develop a detailed knowledge of each country's characteristics as he deals with specific governments and companies.

C. RSI ACQUISITION STRATEGY

While understanding the characteristics of the European contracting environment is an absolute essential prerequisite for the U.S. international acquisition manager, his central most important function is formulating the RSI acquisition strategy. Guidance for developing an acquisition strategy is contained in DOD Instruction 5000.2, which reads as follows: [7:9]

> Acquisition strategy is the conceptual basis of the overall plan that an acquisition manager follows in program execution. It reflects the management concepts that shall be used in directing and controlling all elements of the acquisition in response to specific goals and objectives of the program and in ensuring that the system being acquired satisfies the approved mission need. Acquisition strategy encompasses the entire acquisition process. The strategy shall be developed in sufficient detail, at the time of issuing the solicitations, to permit competitive exploration of alternative system design concepts in the concept development phase. Additionally, sufficient planning must be accomplished for succeeding program phases, including production, for those considerations that may have a direct influence on competition and design efforts by contractors. The acquisition strategy shall evolve through an iterative process and become increasingly definitive in describing the interrelationship of the management, technical, business resource, force structure, support, testing, and other aspects of the program.

The acquisition strategy, therefore, forms the basis for the overall acquisition plan by which the acquisition manager hopes to achieve his program objectives. In the NATO program environment these objectives are

usually set forth in the memoranda of understanding (MOU) signed by the participating countries. The objectives become the basis on which the major areas of the acquisition strategy are formulated. These major areas are: the contracting strategy, business/financial strategy, technical strategy, and integrated logistics support strategy [11:5-1]. The contracting and business/financial strategies will be discussed later since these strategies are associated with the problems that will be addressed in the next chapter.

Each strategy must be tailored to the individual program, as in any acquisition strategy. As the program evolves so does the strategy to allow for change and to reduce the element of risk. The acquisition strategy must never become a rigid plan but must remain flexible enough to change as the program changes. In international programs this flexibility is even more important because there are many more legal restrictions and approvals required [11:5-1].

The RSI acquisition strategy must pursue standardization and interoperability on a priority basis. U.S. emphasis is placed on this to conserve scarce R&D resources and to increase the military effectiveness of Alliance forces. Also included in the strategy should be the consideration of competition to obtain trade-offs between cost, performance, schedule and supportability whenever there is an overall benefit to the NATO participants in the program. The acquisition strategy should be just that, a strategy, for guiding functional implementation plans and not contain planning details itself. The interrelationships among the participating countries' management, technical, business, resource, military force structure, support, testing and other program aspects

should be defined and the strategy should address what responses are desired to program problems disruptive of progress [11:5-2].

In formulating the contracting strategy, the acquisition manager must decide on the contracting approach and methods which will be used. In developing the contracting approach there are several considerations. One consideration is the impact prior contracts or other commitments made before the current acquisition life cycle phase may have on the program. All such commitments or contracts should be identified and the constraints they have on the program understood. This also includes elements of other contracts which may affect sub-systems or components of the program [11:5-6].

For example, the Multiple Launch Rocket System (MLRS) is the basic responsibility of the U.S. Infantry Fighting Vehicles Systems Office, but the M-42 submunitions are the responsibility of the project manager's Office for Selected Ammunition at Picatinny Arsenal. The MLRS XM-445 electronic fuse is being developed by Harry Diamond Laboratories, and the Federal Republic of Germany is developing a scatterable mine warhead for the MLRS. This example should make it obvious that sub-programs may have a significant impact on the primary program [11:5-6].

There are many different types of contracts available to the acquisition manager in deciding on the contracting approach. The difficulty comes in selecting the contract type that fits the particular circumstances and provides a fair and equitable legal relationship for all participants. Each program has a specific set of unique features and the contracting type and approach that is chosen must bring together time, cost, technology and management environment. The acquisition strategy should

allow flexibility and make available many different options for contracting. This enables the acquisition manager to develop a realistic schedule and formulate a contracting strategy which considers competition when beneficial. Resources can then be utilized efficiently and development time reduced since contractor personnel have the flexibility to explore competing approaches. Contracting is not a substitute for management but a tool for management's use. The overall contracting strategy should consider procurement lead times, avoid technical leveling, and encourage innovation in proposals submitted for the next planned increment [11:5-7].

When considering what contracting methodology to use, the acquisition manager has numerous choices during each phase of the acquisition life cycle. The contracting methodology associated with the problems to be discussed in Chapter IV is codevelopment.

Codevelopment is an effective method of transferring technology for cooperative efforts within NATO. Benefits in terms of price and technical competition can be derived from the teaming efforts of domestic and foreign contractors. In cases where one contractor lacks the development and production resources required, teaming through the codevelopment method can provide the necessary development and production resources required. The teams may also be used at some later date to compete for the production contract [11:5-8].

A contracting methodology which is sometimes applied when competition is used during the development phase is the use of a technology transfer clause. This clause in the development contract requires the licensing of technical information to the winner of a production contract if it is

a different company. Royalties and compensation are paid for technical assistance from the licensing contractor. A problem which may be encountered in this strategy is the unwillingness on the part of many companies to part with proprietary information necessary for the success of cooperative efforts. Critical production delays and "buy-ins" by firms seeking trade secrets are sometimes the result [11:5-8].

There are many other contracting methodologies available to the acquisition manager such as a leader-follower arrangement, second sourcing, breakouts, and pre-planned product improvement. Once again, the problem is selecting the right one for each unique situation.

In formulating the business/financial strategy the acquisition manager must consider all program aspects related to funding and budgeting, investment decisions, utilization of personnel and contractor resources, schedule management, business base evaluation and others. Issues, with which the business/financial strategy is concerned, are the amount, timing, and sources of funds, the extent of competition to be infused into the program, and the distribution of development/production tasks among the industrial sectors of the nations participating [11:5-10].

Source selection is one of the major decisions in the business/financial strategy. Political considerations surrounding the issue of offsets often affect this decision. The defense and industrial base of each participating nation must be evaluated, and extensive research may be required. A thorough understanding of industrial base potential by the acquisition manager is necessary to ensure offsets are placed

with the capable industries in each participating nation and the program is structured properly under the political constraints [11:5-10].

In domestic business/financial strategy the use of competition is emphasized throughout a program's life cycle. However, when foreign participation enters a program, the options on competition may be limited to the developmental phase. These limitations may be because of offset requirements, intellectual property rights, or other conditions written into the memorandum of understanding which restrict the acquisition [11:5-10].

Another issue which must be addressed in the business/financial strategy is the efficient utilization of all program resources, which includes support from both domestic and foreign management, systems contractors, government laboratories, universities, and industry. One method which is often used by acquisition managers to limit the number of contracts they have to monitor, is to use an integrating contractor. Under this method a contractor is selected as the major contractor who then coordinates the activities of all other contractors involved in the program. This may be accomplished by either (1) selecting a prime contractor who then subcontracts for the various parts of the program or (2) by the program office placing the contracts and then contracting with a single contractor to provide the technical coordination of the work [11:5-10].

All strategies which have been discussed, as well as other strategies not mentioned, are important, and emphasis must be placed on each by the acquisition manager for successful formulation of the overall RSI acquisition strategy. The appropriateness of this strategy, as developed

by the acquisition manager, will determine the program's success or failure.

D. RSI CONTRACT MANAGEMENT CONSIDERATIONS

The intent of Congress and the executive branch with respect to RSI objectives can be viewed from the contract management standpoint as transnational ventures. Essentially these ventures involve the melding of procuring governments and their industrial counterparts into an effective business arrangement for the proper utilization of resources necessary for a cooperative effort. Successfully accomplishing these RSI objectives requires the acquisition manager to develop an RSI acquisition strategy that provides for the level of NATO sources appropriate for the program. The contracting aspect in developing this strategy is a key element which must receive specific attention. Since much of DOD contracting procedure is rigid and complex, having its basis in public law, it is essential the acquisition manager become sensitive to contract management considerations early on, if the RSI acquisition strategy goals and concepts are to be successfully achieved [11:7-3].

The contracting process starts with a program approval document, that, in the case of codevelopment programs, is a program specific memorandum of understanding (MOU). This document, as stated earlier, is an agreement between participating nations that identifies the program's objectives and goals and forms the basis for the acquisition strategy. The initial drafting of this document, from the contracting point of view, is extremely important to the acquisition manager. Once commitments are made between countries and later become contractual obligations, they are

difficult if not impossible to change. In codevelopment efforts the MOU takes the place of the DAR, which has the force and effect of law. The acquisition manager must ensure no commitments are made which conflict with present procurement laws and regulations and, therefore, are impossible to perform on the part of the U.S. Government or industry. In the past, industry has often been committed to actions which it could not perform. To avoid the above from taking place, it is essential that industry participate as an advisor along with the contract specialist on the acquisition manager's team in the MOU drafting [11:7-5].

The requirement specification is the next major step in the process. It is important contractually that a clear communication of the requirement, understandable by all participants, be obtained. This may be difficult to accomplish given the different languages, but it is absolutely essential if the requirement is to be communicated to potential sources [11:7-5].

The third major step is the purchase request, which integrates the Statements of Work (SOW) and funding citation. The SOW describes what the contractor must do to achieve the contractual requirements and must include any specific efforts and economic participation requirements unique to the program. It must identify whether U.S. or NATO standards will be used and incorporate the business requirements of the MOU. The fund citation may contain certain financial constraints such as the level and timing of national contributions, provisions on currency exchange and the incremental funding plan. All financial constraints and commitments on the part of the participating countries must be communicated

to potential offerors so they are fully aware of all risks being taken in the acquisition and can bid accordingly [11:7-6].

Industry participation is brought into the process by means of the fourth major step, which is the request for proposal (RFP). This document must communicate to industry all aspects of the requirement, including the RSI goals and objectives. The uniform contract format in the DAR can serve as the basic structure of the document but it must be carefully drafted to overcome the language, business, and conceptual understanding differences of the participants. The acquisition manager should ensure all potential sources, both domestic and foreign, are aware of the solicitation by such means as public announcement and presolicitation conferences. DOD policy on acquisitions with foreign source participation is that normally they will be competitive and must meet all requirements such as performance, quality, delivery schedule and cost no more than other comparable products eligible for award [11:7-7].

During the next step of the process, which is the receipt and evaluation of the contractors' proposals, the acquisition manager must be aware that each contractor's recommended solution to the requirement will probably be different along with the business structure that is proposed. The procedure that is used during evaluation must take into consideration the important elements of this business structure which bear on the success of the U.S. achieving the goals established in the MOU [11:7-8].

As the contracting process moves toward award of the contract, a series of negotiations will be conducted. Before any contract is negotiated with a U.S. prime contractor requiring the services of foreign subcontractors or with a foreign prime contractor, several

essential reviews must take place. First, it is necessary to have a review made by DOD for the purpose of identifying those mandatory flow-down provisions which do not pertain to foreign procurements or would not be workable in the procurement in question [11:5-7].

Next, contract provisions should be reviewed before any discussions are held with foreign governments or suppliers to ensure all provisions are required and desired. The results of these reviews must be made available to the DOD or industry negotiating team [11:5-7].

Finally, all problems encountered in the acceptance of mandatory flow-down provisions by foreign governments or suppliers should be documented by the negotiating team and given to DOD for review. The purpose of this review is to delete or revise those provisions which prove to be not applicable in total or part [11:5-7].

When the actual contractual negotiations take place, the acquisition manager must give consideration to support in the form of assistance (which includes audits) from the foreign governments. In cases where foreign subcontractors are involved, the procedures for audit of the foreign contractor's proposals need to be agreed upon by the U.S. and participating European governments. Further considerations, in the area of pricing and audit, will be addressed later. The overall objective critical to the outcome of the negotiations is that all parties arrive at a complete and similar understanding of the contract terms and conditions to avoid non-compliance or misinterpretation of the requirements later [11:7-8].

After contract award, the acquisition manager has several options available for the administration of the contract. For U.S. sources the

normal channels apply, but in the case of foreign sources, contract administration service (CAS) may be performed by the CAS of the specific nation, the U.S. CAS assigned to the particular area, or by a separate CAS organization established specifically for the program [11:7-9].

In addition to the considerations already mentioned throughout the overview of the international contractual process, there are several other legal and financial considerations that impact on contracting in the international environment.

The acquisition manager must consider, in addition to U.S. laws and regulations, certain other international agreements between the U.S. and European nations which govern foreign acquisition. Essentially these agreements provide that the United States may carry out European acquisitions in one of three ways: (1) by acquisition under U.S. laws and regulations without significant constraints by the government of the country where the acquisition is being accomplished; (2) by acquisition only through an agency of the government where the acquisition is being accomplished and under the laws and regulations of that country; (3) or by acquisition under a mixed procedure where U.S. regulations apply in some situations while the regulations of the country where the acquisition is being accomplished apply in other situations. The last procedure is the one which is most commonly used in Europe [11:7-10].

Another basic consideration of the acquisition manager in the legal area is Section VI of the DAR. While the elements of contract law filter through the contract environment, the DAR outlines specific contract management considerations which have the force and effect of law. These considerations involve contract principles, accounting, pricing,

finance, subcontracting, terminations and contract administration. The acquisition manager must deal with this considerable body of guidance and direction when making RSI contract management decisions [11:7-10].

A final legal consideration concerns contract disputes. While the procedures effecting the resolution of domestic contractual disputes are clearly delineated, this is not the case for NATO foreign acquisitions. The U.S. Contracts Disputes Act of 1978 is not applicable and the only practical remedy may be in direct diplomatic negotiations between governments [11:7-17].

The acquisition manager must also recognize several additional considerations in the financial area. The first consideration deals with the various differences in foreign pricing not encountered on domestic contracts. When evaluating foreign suppliers, these differences may affect the evaluation when competition exists so that comparisons between contractors have to be made on a "total cost" basis. In a sole source situation, differences in pricing must be evaluated prior to negotiations with the contractor since many special costs that affect pricing can be reduced through special provisions in the program specific MOU [11:10-9].

In analyzing foreign prices, one difficulty which may be encountered is the reluctance of European contractors to provide detailed cost data. This reluctance is based primarily on the European concept that the market place determines if a price is fair and reasonable. The acquisition manager's only resort in this case may be to try and generate competition and hope it results in a price which is fair and reasonable [11:10-9].

Another difficulty that may be encountered in pricing is the problem of partially hidden costs such as special handling, storage, taxes,

and transportation. Many of these costs which are hidden must be considered as they may become direct costs to the purchaser [11:10-9].

A final pricing difficulty relates to the impact currency exchange arrangements may have on pricing. In an attempt to avoid this problem, the acquisition manager should address in the MOU which currency will be used in pricing the contract, currency exchange timing, currency rate determination bases and currency fluctuation risk sharing [11:10-9].

The last consideration in the financial area discussed concerns audit requirements by the Department of Defense. The increase in collaborative efforts has resulted in a large number of contracts and subcontracts being placed in NATO countries. This has created difficulties for the Defense Contract Audit Agency (DCAA), not only in the audit of these contracts, but also in the compliance of European countries with DAR cost determination principles. A large number of European governments prefer to use their own audit and cost determination regulations and procedures by negotiating special arrangements with the U.S. This has created many problems for the acquisition manager in accommodating the different variations and in determining fair and reasonable contract prices [11:10-6].

The acquisition manager must take these major considerations and others into account as he implements his RSI acquisition strategy and proceeds along each step of the contracting process if the RSI goals and objectives established in the MOU are to be successfully accomplished.

IV. CONTRACTING USING FOREIGN PROCUREMENT REGULATIONS

A. GENERAL

As indicated in the previous chapters, the acquisition manager is confronted with the complex task of effecting business relationships between the parties of transatlantic cooperative efforts. As stated, this requires the melding of procurement systems with substantial differences due to the unique U.S. and European environments from which they evolved. Although difficult, this has been less of a problem in the past because predominately established U.S. procurement policies and procedures, with few deviations to accommodate the foreign countries, have been followed in all efforts involving the U.S.

The few deviations which have been made include the waiver of those provisions which are considered not applicable to contracts with foreign governments or industry and over which the executive branch of the U.S. Government has waiver authority. There exist other provisions which are not applicable, but these have not been waived by the executive branch, due to their basis on statute or law or due to their political sensitivity and therefore reluctance on the part of the U.S. to waive them. DOD made initial efforts to relieve the international contracting process of these statutory provisions by requesting broad authority from Congress to waive any or all conflicting provisions where DOD determined international concerns took precedence over domestic ones. Congress did not allow this authority because of concern over the preservation of the U.S. competitive process and the lack of assurance

that U.S. industry and labor would receive equitable treatment while disparities between U.S. and European industrial capabilities were being resolved.

These statutory provisions have been reluctantly accepted by foreign countries in the past because failure to do so on their part would mean that U.S. appropriations could not be spent in their countries. However, within the past two years foreign countries (primarily the Federal Republic of Germany and the United Kingdom) have been pursuing the utilization of their procurement procedures. Their argument has followed basically two lines: (1) as a sovereign government, the laws and regulations of other governments should not be applicable; and (2) it is inefficient to require industry to apply two sets of contracting policies and procedures. Both of these arguments have some merit.

Now that the European countries are achieving a true partnership with the U.S. and are putting increased emphasis on achieving NATO defense efforts, they feel it is time the U.S. accepted their sovereignty on these issues. Therefore, the waiver of only a few of the U.S. procurement provisions, not applicable to contracts with foreign governments and industry, is just a temporary measure. It is uncertain how much longer U.S. contracting provisions will be accepted. The Europeans expect further action on the part of the U.S. if they are to continue to participate in cooperative efforts.

B. CENTRAL ISSUE

The question which has to be addressed when contracting with foreign governments and industries is "whose procurement policies and practices

will be followed?" As stated, DOD policy is presently to apply U.S. procurement policies and procedures with the exception of those provisions, such as socio-economic clauses, which are not applicable in contracting with foreign countries. The basis for this policy is fair and equal competition. The belief, in general, is that foreign firms should not be treated any differently than U.S. firms. Any foreign firm competing for a contract in the U.S. should have to comply with the same procurement policies and procedures that competing U.S. firms must accommodate or foreign industries may have an unfair advantage over U.S. industries. In turn, it is the policy of the U.S. to interpose no objections to the application of any foreign procurement policies and procedures considered appropriate by foreign governments or industry when contracting directly with U.S. companies.

The objective of this policy is not to force U.S. procurement rules and regulations on foreign countries, as evidenced by the acceptance of their regulations when they are the contracting country, but to maintain the essential element on which U.S. procurement is based--fair and equal competition. This is an element which, as mentioned in previous chapters, is not considered a critical element of the European procurement system.

To date, this policy has been basically adhered to with only the application of certain U.S. contracting provisions being waived as a result of increasing pressure from foreign countries. Many of these provisions, such as socio-economic clauses and others, are justified in being waived as they were never applicable to contracting with foreign countries from the start. Still other provisions, as stated earlier, are

not applicable and should have been waived but have not because they are based on statutes or law or due to their sensitivity. However, the central issue does not lie with any of these provisions because they do not have a major impact on the fair and equal competition between U.S. and foreign contractors but only create an administrative burden to the timely execution of the contracting process.

The U.S. contracting provisions which have created the greatest impact and which might lead to an unfair competitive advantage for foreign contractors, if they are allowed to use their own regulations, are U.S. pricing and audit provisions. The Defense Acquisition Regulations (DAR), Section XV defines the costs incurred that are allowable in contracts entered into with DOD. The allowability or non-allowability of several of these cost elements are based on statute while others are regulatory. Because of the concept of fair and equal competition stated above and other reasons there has been a reluctance by the Department of Defense to grant any waivers to these cost allowability principles, whether regulatory or based on statute, although these charges may be considered normal and acceptable by foreign businesses and governments.

DAR, Appendix O, Cost Accounting Standards, defines the allocability of costs. Likewise, the cost accounting principles of foreign business and governments may vary widely from these principles. In some cases these variations may only be theoretical differences with no practical change in costs allocated to a particular contract while in other cases there may be a material change in costs allocated. In both cases of allowability and allocability, partial waivers allowing foreign countries to use their regulations have been granted for those

provisions not based on statute only after very long, tedious and administratively costly reviews of the cost accounting principles in use by the foreign firm or country. These waivers have only been granted on a case by case basis and can, in no sense, be taken as a sign of willingness by DOD to obtain additional waivers. An exception to this is the recent waiver on a permanent basis of all cost accounting standards (CAS) for contracts and subcontracts awarded to foreign governments and their agencies and the waiver of all CAS except 401 (Consistency in Estimating, Accumulating and Reporting Costs) and 402 (Consistency in Allocating Costs Incurred for the Same Purpose) for all foreign firms.

The other difficult area concerns audit provisions. It is preferred that audit of foreign contractors be performed by the Defense Contract Audit Agency (DCAA). However, foreign firms and governments have begun to insist on the use of their own auditors. Waivers have been granted that allow auditors of foreign governments to act as representatives of the U.S. in auditing foreign contracts and subcontracts. This is another provision that creates significant problems for the U.S.

The waiver of these provisions has had the greatest impact on the effecting of business relationships between the parties of transatlantic cooperative efforts. The problems created for the U.S. Government and industry will be identified in the following sections.

C. IMPACT ON THE ACQUISITION MANAGER

The use of foreign procurement regulations (primarily pricing and audit) has a significant impact on the acquisition manager. To date,

only foreign procurement regulations, modified to include required U.S. statutory contractual provisions, have been utilized in a limited number of programs but the problems that can be experienced are apparent.

The acquisition manager already must contend with the difficult interpretation and application of complex Defense Acquisition Regulations (DAR). When foreign regulations are interjected, the process is made even more complex. In the programs where modified foreign regulations have been used, acquisition managers have indicated they do not have a thorough understanding of foreign procurement regulations. This contributed to the difficulty of effecting a business relationship between the parties of the programs.

Many times the first problem encountered by the acquisition manager is obtaining an English translation of the foreign regulations so they can be compared to the DAR. Even if this is possible or has already been accomplished, the possibility still exists for differences in interpretation due to semantics.

The acquisition manager then is faced with obtaining a thorough knowledge of a procurement system and regulations based on traditional values which have evolved from a totally different environment. A compromise between these regulations and U.S. procurement regulations, at best, is difficult.

In contracts that involve both U.S. and foreign competing sources, the acquisition manager is responsible for determining that the source selected is the most competitive, price and other factors considered. When foreign procurement regulations are utilized, even in a modified form, this process becomes more complicated. When two sets of

procurement regulations are being applied, it is difficult to determine if fair and equal competition exists because the competing contractors are not subject to the same restrictive provisions. One contractor may be required to bear a number of costs not required of the other contractor, providing the other contractor with an unfair advantage.

Even more difficult is the determination of a fair and reasonable price. DOD pricing policy, as to foreign contracts and subcontracts, states: [13:2]

> It is a prerequisite to entering into any contract for the Department of Defense (DOD) that the cognizant contracting officer (CO) make a finding that the price to be paid for the property or services to be purchased is reasonable.

There are basically two problems in this area. The first problem is obtaining the cost and pricing data in the proper format required. Under foreign pricing regulations, there are many differences in the accounting systems for accumulating costs as well as major differnces in cost allowability and allocability. Foreign countries are reluctant to change their traditional accounting methods in order to break out costs differently to meet U.S. requirements. Even when this is done, there is considerable doubt as to the validity of the cost and pricing data because many costs cannot be broken out successfully by the foreign country. Seldom is all required cost and pricing data provided initially. Usually several requests for specific items of data are necessary to obtain enough data so that adequate pricing can be performed.

The second problem is that a foreign country's auditors acting as representatives of the U.S. in providing pricing support often are inexperienced in U.S. requirements and incapable of providing the pricing

support normally expected of U.S. auditors. While the acquisition manager can request support in these instances from the U.S. Defense Contract Audit Agency (DCAA) in the foreign country, this creates the additional burden of having to evaluate the foreign country's accounting system and audit capability to determine if this is required.

When foreign procurement regulations are utilized, the acquisition manager can experience problems concerning contract flow-down provisions. This occurs when a U.S. prime contractor is subcontracting with foreign industry. The U.S. Government flows-down contractual provisions applicable to prime contractors to the prime's subcontractors. These flow-down provisions ensure that U.S. Government objectives and cost controls are met by the subcontractor and monitored by the prime contractor. When foreign procurement regulations are utilized by the foreign subcontractors, certain U.S. flow-down provisions cannot be applied directly. For example, a flow-down clause in every contract is audited by the Department of Defense. When a foreign country's auditors act as representatives of the U.S., direct access to the records of the foreign subcontractor is not available to the prime except through the foreign auditors. If costs are not controlled, this provides an avenue for the prime to make a case for not being held accountable by the U.S. Government. Since the prime could not audit or gain access to the subcontractor's records, the prime could claim the controls were not actually available for monitoring the subcontractor.

These problems all contribute to greater complexity in contract evaluation and administration. This only tends to increase procurement lead time and contract costs.

These are a few of the problems that can impact the acquisition manager when foreign procurement regulations are used in contracting. Many other problems may develop if these regulations are applied in total without any modification for required U.S. procurement provisions.

D. IMPACT ON U.S. INDUSTRY

The impact of using foreign procurement regulations does not only affect the acquisition manager but U.S. industry as well. U.S. industry also must deal with the problem of interpreting complex procurement regulations when foreign regulations are interjected into a program along with the DAR. Obtaining a translation of the regulations into English and the differences created by semantics are again complications. The general consensus of several U.S. industry personnel involved in a multinational cooperative effort is that U.S. industry does not have a detailed understanding of foreign procurement regulations, but understands them well enough to enter into a business relationship with foreign countries.

What is considered to be a greater difficulty by industry is obtaining the support from the U.S. Government in establishing these business relationships. When the memorandum of understanding (MOU) for a cooperative effort is negotiated between governments and issues involving the use of foreign procurement regulations are not resolved even though the MOU is signed, the burden of resolving these issues falls on industry. U.S. industry personnel have indicated that, without cooperation of the governments involved, U.S. industry cannot resolve these issues with

foreign industry and therefore encounters problems in establishing a business relationship. U.S. industry's view is that participation in the MOU negotiating process, if only as an advisor, would prevent MOU's that cannot be performed contractually from being negotiated. Once an MOU is negotiated and signed and a prime U.S. contractor is required ccntractually to carry out the provisions of the MOU, obtaining U.S. Government support to resolve issues that should have been resolved when the MOU was negotiated is a time consuming process. The prime U.S. contractor operating under a contract with real cost and schedule requirements is not in the position to resolve these issues. The administrative burden alone is prohibitive.

The actual contractual provisions U.S. industry has experienced the greatest difficulty with in using foreign procurement regulations when contracting with foreign countries are the pricing and audit provisions. The first problem involved with using foreign pricing provisions is obtaining all the cost and pricing data necessary to adequately price out a contract. Foreign industries are not required to give their governments the volume of data required of U.S. industry. So, even though U.S. industry requests the full amount of cost and pricing data required on a DD-633, what is received initially is not adequate. U.S. industry has to request several times specific items of data before enough information is received to adequately price out the contract. Also, foreign industry may be reluctant to provide the data because of the European view of a fair price as being whatever the market will bear or because their accounting system does not accumulate the cost data in the format required. All in all, the result is considerable delay.

The second problem concerns the validity of the cost and pricing data received. Many costs are buried in more than one area and again foreign accounting systems may not be capable of breaking these costs out accurately. When the differences between U.S. and foreign regulations concerning allowability and allocability are included, U.S. industry is faced with an even greater problem in identifying valid cost and pricing data.

These problems create considerable delay in obtaining complete and accurate pricing data from foreign industry and cause U.S. contractors, who are competing for a prime contract, to obtain subcontract pricing data from only U.S. sources to support their proposals even though foreign sources will be involved. This may result in additional costs being incurred which have to be paid by the U.S. contractors.

Finally, the increased use of foreign procurement regulations tends to create a more lenient situation for foreign industry than U.S. industry. As the U.S. has gradually modified its procurement regulations, European countries have not done the same. This has resulted in greater restrictions being placed on U.S. industry. If this continues, U.S. industry will not be able to compete fairly and equally with foreign industry for U.S. contracts. The U.S. Treasury has already expressed this concern by stating: [14:22]

> Any modification of certain laws and procurement regulations to reduce friction caused by U.S. regulations could create a more lenient situation for foreign producers than for domestic producers. We agree that such a situation should not develop and that any modification of U.S. regulations be made only if equivalent actions are undertaken by foreign countries toward U.S. industry and no reduction of procurement standards is created.

Cooperative efforts with the NATO European nations are desired but only if these efforts can be met while maintaining the basic premise of the U.S. procurement system, which is fair and equal competition.

E. IMPLICATIONS FOR DOD

The problems encountered by the acquisition manager and U.S. industry in the use of foreign procurement regulations have significant implications for the Department of Defense (DOD). If DOD continues to modify U.S. procurement regulations to accommodate foreign countries, it will have to operate under two systems: the present competitive U.S. system and a unique non-competitive system for contracting with foreign countries. As stated in previous sections, this is because the restrictions placed on U.S. industry by U.S. procurement regulations will not apply to foreign industries. The basic premise of U.S. procurement, fair and equal competition, will be violated as well, and U.S. industry will be placed at a disadvantage which could result in a substantial economic impact.

U.S. acquisition personnel will have to become knowledgeable in the business, legal, and policy differences of every foreign country since each is different and business relationships will have to be tailored to the regulations of the countries involved. Training will be a time consuming and costly process. Also, an initial shortage of qualified personnel will be experienced.

The complexity of business relationships will make contract evaluation and administration more difficult and costly. Procurement control will be difficult to maintain.

Further, significant modification of U.S. defense acquisition regulations to accommodate foreign procurement systems will only set a precedent for continued modification of other defense acquisition regulations. Justification for not modifying DAR provisions will become more difficult for the U.S.

Finally, the increased complexity of accomplishing cooperative efforts will lengthen the procurement lead time, making these efforts more costly. This may discourage future participation by the U.S. in cooperative programs since an overall goal is cost savings for the U.S. as well as NATO.

Many of the problems identified in this chapter which hold implications such as these for DOD are illustrated in present and ongoing programs. One such program will be reviewed in the next chapter.

V. EXPERIENCES WITH THE ROLLING AIRFRAME MISSILE (RAM) PROGRAM

A. GENERAL

The application of foreign procurement regulations has been on a case-by-case basis and to a limited number of programs. U.S./European multinational programs have been affected by the waiver of U.S. Defense Acquisition Regulations (DAR) deemed not applicable to foreign countries but few U.S. involved programs have then allowed the application of foreign procurement regulations in place of U.S. provisions. The Rolling Airframe Missile (RAM) program is such a case and therefore is an excellent example of the problems encountered in the use of foreign procurement regulations.

B. RAM PROGRAM AGREEMENT

The Rolling Airframe Missile (RAM) program is a codevelopment/coproduction of an advanced surface-to-air missile system. On 22 July 1976, the United States (U.S.) and Federal Republic of Germany (FRG) became participating governments under a memorandum of understanding (MOU) for the cooperative development phase of the program. The intent of the governments was and is to proceed in two phases for the development: cooperative development (the current MOU) and full-scale engineering development (FSED).

With the cooperative development nearly completed at the end of 1978, both governments and Denmark (DK), as a new participating government, desired to enter into an MOU for the purpose of conducting the FSED phase of the development. It was also the intent of all parties that General

Dynamics (GD), Pomona Division, be the prime contractor for this effort, that some of the work be subcontracted to one or more FRG firms, but that no work be subcontracted to DK industry.

The U.S. Navy informed GD that the MOU and prime contract would contain a provision that encouraged the prime contractor for the FSED phase to solicit sources in the FRG. Therefore, with this verbal indication, GD proceeded to solicit sources in the FRG using standard procurement methodology with the exception that U.S. Government concurrence with the selection of a subcontractor would be received prior to announcing the winner of the competition. GD had already solicited U.S. sources in order to substantiate the prime contract proposal presently being negotiated. However, GD decided that the most competitive U.S./FRG source, price and all other factors considered, would be selected as the winner of the competition. As stated, there was no MOU or prime contract at this point; both were being negotiated.

In reviewing plans with government agencies and briefing prospective suppliers, GD continually stressed the intended use of contract terms and conditions consistent with U.S. Government procurement regulations. Every time GD met with prospective FRG suppliers, GD was informed that the use of FRG procurement regulations (particularly audit and pricing regulations) was required for FRG sources though U.S. provisions had been used in the past. The German firms contacted by GD cited their own regulations (Verordnung uel er Preise bei Deffenilichen Auftraegan, Regulations on Pricing in Public Contracts, and the Leitsatze fur Preisermittlung Aufgrund von Selbstkosten, Rules for the Determination of Cost Pricing) as more appropriate than the cited U.S. clauses

(DAR Clause 7-104.41, Audit by Department of Defense, and DAR Clause 7-104.42(a), Subcontracting Cost or Pricing Data). In the briefings to both governments and the RAM program international steering committee, GD advised that problems were being experienced in these areas and were prohibiting GD from effecting a business relationship with FRG industry. GD requested that relief be provided in the MOU and prime contract.

When the MOU was signed in March 1979 and the prime contract awarded in June 1979, neither document contained the relief GD required. However, the Navy contract did contain specific language concerning subcontracting in the FRG and the flow-down of U.S. contracting provisions to FRG subcontracts. The contract specified concerning subcontracting in the FRG:

> The contractor shall award subcontracts to industry in the Federal Republic of Germany if it is determined that industry in the Federal Republic of Germany is the most competitive source considering all factors such as the technical and management capabilities of the sources, the schedule implications and the cost to the program. Notwithstanding any provisions of the subcontracts clause to the contrary, the contractor shall not enter into subcontracts with industry from the Federal Republic of Germany without the prior written consent of the contracting officer.

The contract further provides for the flow-down of the terms and provisions of the prime contract to any potential FRG subcontracts. It states:

> The contract contemplates the exercise of the contractor's best efforts to obtain the inclusion in FRG subcontract(s) of provisions of this contract required by the terms of this contract to be so included hereinafter referred to as flow-down provisions. In the event of refusal by a subcontractor to accept these flow-down provisions, the contractor:
>
> (1) shall promptly submit a written report to the procuring contracting officer setting forth the subcontractor's reason for such refusal and other pertinent information which may expedite disposition of the matter; and

(2) shall not proceed with award of subcontract without the written authorization of the procuring contracting officer.

Any subcontractor flow-down requirements shall be subject to the right of the procuring contracting officer, at his own instance or upon request of the contractor, whether to modify or to waive in writing such flow-down requirements whenever he determines that he is not legally compelled to maintain such requirements, and when the respective modification or waivers, in his judgment, are in the interest of the government.

These clauses resulted from the MOU between participating governments for the cooperative FSED phase of the program.

After further attempts to persuade FRG sources to accept U.S. contract clauses on pricing and audit were unsuccessful, GD requested relief from passing these provisions on to FRG subcontractors. At this point, GD was operating under a prime contract with real performance, schedule, funding and legal constraints and a number of FRG firms that had been selected on the basis of competition to perform in some areas but with which GD could not effect a business relationship. GD had to subcontract with someone to meet the prime contract obligations and if the issues of pricing and audit could not be resolved in a timely manner, it would not be FRG industry.

The contracting officer determined, based on GD's efforts, that FRG sources would not accept subcontracts with U.S. DAR audit and pricing provisions. Action was taken to request waivers that would exempt FRG sources on the RAM program from the requirements of audit by DOD and subcontractor cost or pricing data clauses. A waiver of these clauses would permit GD to incorporate FRG regulations into the subcontracts with FRG sources.

The request for waiver was forwarded from the Naval Sea Systems Command (NAVSEA) via the Chief of Naval Material (CNM) to the Assistant Secretary of the Navy (Manpower, Reserve Affairs and Logistics). The request was rejected at the ASN (M, RA&L) level on the basis that alternative U.S. sources existed and the request could not be fully justified. The burden was placed on GD to work out the differences with FRG subcontractors.

GD once again commenced discussions with FRG sources in an attempt to resolve the issue. These discussions led GD to discover the minutes of a meeting between the U.S. Cost Accounting Standards Board (CASB) and the FRG government, dated June 1978, wherein the CASB addressed issues such as allowability and unallowability of costs under DAR versus VOPR. The Discussions also led to the discovery of an umbrella MOU between the U.S. and FRG governments addressing audits and audit agencies. These minutes and MOU were taken to be firm agreements by the FRG government. On the other hand, not all levels of the U.S. Government recognized these documents as such.

The agreements provided that for subcontracts awarded to FRG industry, U.S. cost accounting standards would be substituted by German pricing regulations (VOPR) and audits would be performed by the FRG Federal Office of Military Technology and Procurement (BWB). As a result of GD's discussion with the FRG Government and industry, a special provision which reflected aspects of the meeting held between the U.S. CASB and the FRG Government was drafted with their assistance for inclusion in the prime and each subcontract. The special provision covered both accounting principles and audit procedures. This special

provision was finally approved by the FRG Ministry of Defense and the U.S. Under Secretary of Defense (Research and Engineering).

The result of the agreement was a compromise between U.S. and FRG procurement regulations. The special provision developed is as follows:

> It is the understanding between the parties that the Governments of the Federal Republic of Germany and the United States are planning to arrange for updating existing agreements between the governments regarding the application of national pricing rules and regulations and audit practices used in acquisitions involving the two governments. Until such time as an updated agreement is reached and implemented by the two governments the following shall apply to this subcontract only:
>
> A. Accounting Principles
>
> The seller shall utilize the cost principles set forth in the VOPR 30/53 including the Leitsatze fur Preisermittlung Aufgrund von Selbstkosten (LSP) (appendix to the VOPR 30/53).
>
> It is agreed, that the following costs unallowable under DAR Section XV are disallowable under VOPR 30/53 too:
>
> -- Bad debts
> -- Idle facilities
> -- Losses on other contracts
> -- Cost of organization and reorganization
> -- Uneconomical leasing and rental cost
> -- Product-related advertising expenses
> -- Expenses for recreation, entertainment, and the like
> -- Interest and other financial costs
> -- Plant reconversion as agreed by purchase order
> -- Uneconomical relocation
>
> The following costs allowable under the provisions of VOPR 30/53 but unallowable under DAR Section XV will be subject to negotiations between the parties to the subcontracts in order to comply with DAR Section XV unallowables:
>
> -- Advertising costs (to the extent unallowable by U.S. statutes)
> -- Contributions and donations
> -- Bid and proposal (to the extent unallowable by U.S. statutes)

-- Depreciation on the basis of replacement costs
-- Independent research and development, if applicable
(to the extent unallowable by U.S. statutes)

(If the contractor customarily uses the replacement cost to determine depreciation costs, the contract cost will be computed as if depreciation had been based on the actual acquisition cost. The invested capital on which the calculation of the imputed interest is based will be adjusted in the same manner. These adjustments may be effected in the form of lump sum adjustments.)

It is understood and agreed that application of the German pricing regulations to U.S. contracts does not prejudice questions concerning the rate of profit or fee to be earned under this subcontract. It is recognized that the rate of profit or fee or amount of profit or fee will remain subject to the negotiations by the contract parties concerned and that deviations from the German pricing regulations (items of cost which are deemed unallowable under DAR) will be taken into account in negotiating the rates of profit or fee for this subcontract.

B. Designation of Audit Agency

With the exception of clause entitled examination of records by Comptroller General, the Federal Office of Military Technology and Procurement (BWB) in the Federal Republic of Germany has been authorized as the representative of the U.S. Government and buyer as set forth in the clause, Audit by the Department of Defense, and any provisions of this subcontract expressly or by reasonable implication contemplating access to records of the seller, for conducting proposal price and cost reviews, actual cost audits and audits to determine allowability of costs in accordance with the principles set forth in A. above entitled "Accounting Principles," of subcontracts at any tier within the Federal Republic of Germany under the RAM Contract N00024-79-C-5202.

In the event the prime contract is modified to reflect agreements reached between the two governments, then the parties shall agree to enter into negotiation in good faith to modify this subcontract.

This special provision allowed GD and FRG industry to effect a business relationship. The agreement resulting in this provision was reached at the last possible moment. GD could not negotiate with FRG

industry any longer and would have had no alternative but to revert to U.S. sources. This provision allowed contracts for RAM to be awarded to FRG industry in August 1979.

This brief overview of the RAM program illustrates only a few of the problems for the acquisition manager and U.S. industry which result from the use of foreign procurement regulations and how these problems were approached in a specific program. As identified in Chapter IV, there are many more problems which result from their use.

VI. CONCLUSIONS AND RECOMMENDATIONS

A. CONCLUSIONS

1. As identified in the research, the U.S. and European procurement systems have evolved from different environments. The Europeans have essentially a non-competitive system with close relationships between government and industry. On the other hand, the U.S. system has competition as its basic premise and belief in maintaining an arms-length relationship between government and industry. Any attempt to arrive at a compromise by modifying the regulations of both procurement systems will almost certainly be unsuccessful.

The modification of U.S. and FRG procurement regulations which occurred in the RAM program was successful only because the statutory provisions of the U.S. procurement system were not waived. This clearly left U.S. regulations dominating the procurement and therefore the existence of a competitive system for source selection. As a result, a true compromise between U.S. and FRG regulations was not achieved. However, what did become apparent were the many problems that will be encountered in trying to manage a program operating with the modified regulations of two different procurement systems.

While certain regulations which are not applicable to doing business with foreign countries should be waived permanently, the U.S. cannot afford to waive those provisions founded on statutory requirements which form the basis of its procurement system. If this ever occurs, competitive procurement will no longer be achieved in multinational cooperative efforts.

2. Memoranda of understanding are important agreements which must specifically address the application of procurement laws and regulations which affect acquisitions under the MOU. These issues must be resolved by the participating governments and not left to U.S. industry for resolution once the provisions of the MOU have become contractual clauses.

3. Acquisition personnel in both the U.S. Government and industry do not have a thorough understanding of foreign procurement regulations. However, the general consensus is these personnel understand them well enough to effect business relationships with foreign countries. There is room for speculation as to the validity of this statement. Even if this is true, it will be difficult to obtain a working knowledge sufficient to successfully contract using each European country's variation in regulations.

4. Obtaining cost and pricing data from foreign sources is a time consuming process under U.S. cost and pricing regulations and the validity of such data cannot always be assured. When foreign cost and pricing regulations are used, the process becomes even more complex because agreements with each foreign country have to be reached concerning the allowability and allocability of costs. Failure to reach an agreement which protects the competitive procurement process may result in foreign industry attaining a significant advantage over U.S. industry.

B. RECOMMENDATIONS

1. Direct contracting between the U.S. and European countries should not be accomplished by modifying U.S. and European regulations with the

exception of waiving on a permanent basis those procurement regulations not applicable to international acquisition. The procurement regulations of the contracting country which has been designated the sponsoring country or prime contractor for the multinational acquisition should be utilized. This ensures that the sponsoring government and prime contractor responsible for managing the program have to deal with only one set of procurement regulations of which they have a thorough understanding. The U.S. should be prepared to utilize the procurement regulations of the European country that has been designated the sponsoring country and prime contractor.

This contracting policy is not completely problem free. Accounting systems may have to be modified to account for and break out costs in the format required by another country but this will be far less difficult to accomplish than the modifying of various procurement systems on a country-by-country basis.

2. General MOU's should specifically address the issue of procurement regulations and procedures that will be used. U.S. procurement regulations not applicable to international acquisition should be waived on a permanent basis and stated in the general MOU with each European country. Obtaining waivers for these provisions on a recurring basis is time consuming as well as an unnecessary administrative burden on the acquisition manager and industry.

C. AREAS OF FURTHER RESEARCH

The NATO Explosion Resistant Multi Influence Sweep System (ERMISS) program involves contracting in accordance with procurement regulations

of the Federal Republic of Germany (FRG). The FRG is the sponsoring country and prime contractor and will place subcontracts for elements of the program with European and U.S. industries. B.F. Goodrich is one such U.S. industry.

The contracting policy utilized in the ERMISS program is a model for what should be the preferred method of direct contracting in co-operative efforts. A case study of the ERMISS program could be performed and a comparison made with the results of the Rolling Airframe Missile (RAM) program.

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